Monday, 4 December 2023

Rate Pause to Close Out 2023

The Reserve Bank's (RBA) final meeting of 2023 will likely hog the limelight this week, despite broad consensus that rates will remain on hold.

The RBA's December meeting will take place tomorrow and it appears that this is likely to be a routine affair. Interest rate markets have priced in virtually no chance of a hike at tomorrow's meeting. This view is supported by economists, the majority of whom are expecting the RBA Board to close off the year by leaving the cash rate unchanged.

The RBA Board has made it clear that they will remain on hold if the data evolves broadly in line with the Bank's forecasts. It will take an upside inflation surprise for the Board to pull the trigger again and since the last meeting, the data has presented little new information that would trouble the Board. If anything, last week's monthly inflation read points to continued moderation in goods inflation, which will help the RBA with its inflation fight.

Consistent with this, we expect that cash rate to remain unchanged at tomorrow's meeting. However, this does not mean the RBA is finished with rate hikes. While our central view remains that we are at the cash rate peak, an upside surprise cannot be ruled out, particularly on the services side of the economy.

Research we released last week suggests that as growth in the capital stock (i.e. machines, equipment and infrastructure) catches up to the strong population growth, labour productivity should stabilise before increasing. This will help reduce labour costs and inflationary pressures. The RBA seems to be concerned that this is not happening quickly enough, something that could be validated by the incoming data.

Apart from the RBA, this week features a heavy data schedule, culminating in the release of the September quarter National Accounts on Wednesday. We expect GDP rose 0.4% in the September quarter and 2.1% through the year.

This morning we received important data on the business sector, which feeds into the National Accounts release. This included business profits, which fell 1.3%, business inventories, which jumped 1.2% and business wages and salaries, which increased a strong 2.7%.

When excluding the mining sector, which is being impacted by volatile commodity prices, profits look vastly different. Non-mining profits rebounded 3.4% in the quarter, to be 15.7% higher in annual terms.

The increase in business inventories was larger than expected and will add around 0.9 percentage points to quarterly GDP growth. This presents some upside risks to our current forecast.

Tomorrow, we will receive updated data on net exports and spending by the public or government sector. Net exports are expected to detract from economic growth while government spending, particularly on infrastructure investment, is expected to support activity.

Also released this morning was housing finance data for October. New housing finance has established a solid uptrend since the start of the year, coinciding with the run-up in dwelling prices nationally. This continued in October. The value of new housing finance (excl. refinancing) rose 5.4% in October, the largest monthly jump since May. This was driven by both owner-occupier (5.6%) and investor (5.0%) lending.

International Data

Offshore, the focus will be on the US nonfarm payrolls release on Friday. The narrative has shifted rapidly in the US over recent weeks alongside widening evidence that inflation is coming down and that the economy is undergoing an orderly slowdown. Markets have since firmed expectations that the Fed is done hiking rates and has moved to aggressively price in rate cuts next year. There are now five 25-basis rate cuts fully priced into markets for 2024. This is despite Fed chair Jerome Powell consistently suggesting rate cuts remain a long way off.

Equities and bond markets have rallied on the back of the repricing in interest rate expectations, and it could be that markets have moved too far. This increases the event risk from Friday's non-farm payrolls release.

The labour market is central to this underlying story that economy and inflation are slowing down. Consensus is for payrolls to increase by 180k in November, slightly higher than the 150k recorded in October, but below the strong pace from earlier in the year. An upside surprise could raise some doubts about the current market positioning, while a result in-line or below expectations will support the idea that rate cuts in the US are on the horizon.

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Group Forecasts

		2023	2024				2025
End Period:	**Close (01 Dec)**	**Q4 (f)**	**Q1 (f)**	**Q2 (f)**	**Q3 (f)**	**Q4 (f)**	**Q1 (f)**
Aust. Interest Rates:							
RBA Cash Rate, %	4.35	4.35	4.35	4.35	4.10	3.85	3.60
90 Day BBSW, %	4.37	4.55	4.55	4.47	4.22	3.97	3.72
3 Year Swap, %	4.18	4.50	4.40	4.30	4.20	4.10	3.90
10 Year Bond, %	4.49	4.70	4.60	4.50	4.40	4.30	4.15
US Interest Rates:							
Fed Funds Rate, %	5.375	5.375	5.125	4.875	4.625	4.375	4.125
US 10 Year Bond, %	4.20	4.80	4.70	4.60	4.50	4.40	4.20
USD Exchange Rates:							
AUD-USD	0.6675	0.66	0.67	0.68	0.69	0.70	0.71
USD-JPY	146.82	149	147	144	141	138	135
EUR-USD	1.0884	1.08	1.09	1.11	1.13	1.14	1.15
GBP-USD	1.2710	1.23	1.24	1.25	1.26	1.27	1.28
NZD-USD	0.6209	0.60	0.61	0.62	0.62	0.62	0.63
AUD Exchange Rates:							
AUD-USD	0.6675	0.66	0.67	0.68	0.69	0.70	0.71
AUD-EUR	0.6133	0.61	0.61	0.61	0.61	0.61	0.62
AUD-JPY	98.01	98.3	98.5	97.9	97.3	96.6	95.9
AUD-GBP	0.5252	0.54	0.54	0.54	0.55	0.55	0.55
AUD-NZD	1.0750	1.09	1.10	1.11	1.11	1.12	1.13

	2021	**2022**	**2023 (f)**	**2024 (f)**
GDP, %	4.6	2.7	1.2	1.6
CPI (Headline), %	3.5	7.8	4.6	3.4
CPI (Trimmed mean), %	2.6	6.8	4.4	3.3
Unemployment Rate, %	4.7	3.5	3.8	4.7
Wages Growth, %	2.4	3.3	4.1	3.2

AUD cross exchange rates have been rounded.

Financial forecasts are quarter end.

GDP, CPI, employment and wage growth forecasts are year end.

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